

WASHINGTON STATE DEPARTMENT OF REVENUE

SPECIAL NOTICE

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High Technology Business Tax Incentives:

Sales/Use Tax Deferral/Waiver Program & B&O Tax Credit Program Extended and Revised Small Business Grants Exempted from B&O Tax

ESHB 2546 (Chapter 2, Laws of 2004)

During the 2004 legislative session, the Legislature passed Engrossed Substitute House Bill 2546 (Chapter 2, Laws of 2004). This bill made substantial changes to tax incentive programs for high technology businesses. This special notice summarizes those changes.

High Tech B&O Tax Credit Program

Effective **June 10, 2004**, the high technology business and occupation (B&O) tax credit program for research and development (R&D) in the fields of advanced computing, advanced materials, biotechnology, electronic device technology, and environmental technology is modified as follows:

The expiration date for the program is extended to January 1, 2015.

The way in which the credit is calculated is changed. Because the law change takes place in the middle of a month, for the administrative convenience of both taxpayers and the Department of Revenue, the old method of calculation will apply for taxable activity through the end of June 2004. For taxable activity on and after July 1, 2004, the new method of calculation will be used. The method is described later in this notice.

Persons will no longer file a Declaration, Research and Development Credit form (Rev 26 0003) with the tax return in which they are claiming the credit.

Persons claiming the credit must file an annual survey. This document is due by March 31st of the year following any year in which a credit is taken. If a person fails to complete the survey by the due date, that person is not eligible to take the credit for the entire year in which the survey was due.

New Method for Calculating High Tech Research and Development B&O Tax Credit

For taxable periods starting July 1, 2004, the credit is calculated as follows:

1. A business must first determine the greater of:

The amount of its qualified research and development expenditures

or

80% of amounts received by a person other than a public educational or research institution as compensation for the conduct of qualified research and development

2. From this amount, the business subtracts 0.92% of its taxable amount. If 0.92% of the taxable amount exceeds the amount determined in step one, the business is not eligible for the credit. The **taxable amount** is the total amount subject to business and occupation tax after deductions are taken. Taxable amount does not include any amount for which a multiple activities tax credit is allowed.

3. The credit is determined by multiplying the resulting amount by:

0.484% in the case of a nonprofit corporation or nonprofit association engaging in research and development

or

The person's average tax rate for every other person

4. A person's **average tax rate** is the person's total business and occupation tax liability for the reporting period (before determining the amount of this credit) divided by that person's taxable income, for business and occupation tax purposes, for the reporting period.

5. **Taxable income** has almost the same meaning as taxable amount. Taxable income does not, however, include amounts attributable to the value of products. Those are amounts reported on the combined excise tax return for manufacturing and extracting activities.

The Legislature may not have intended taxable income to have a different meaning than taxable amount. It is possible that during the 2005 legislative session the Legislature will consider legislation, retroactive to June 10, 2004, to substitute taxable amount for taxable income in the computation of a person's average tax rate. This would mean a change only for persons who report manufacturing or extracting activities.

If the Legislature does enact retroactive legislation substituting taxable amount for taxable income:

- a. Taxpayers reporting manufacturing or extracting activities, along with other activities, may have claimed too much credit. The Department of Revenue anticipates that it will bill such persons for any excess credit claimed, plus interest, but not penalties.
- b. Taxpayers who report only manufacturing or extracting activities will not have been able to claim any credit because they have no taxable income to use in computing their average tax rate. These taxpayers will be entitled to a refund in the amount of the credit, plus interest.

Taxpayers, in anticipation of retroactive legislation, may elect to use taxable amount instead of taxable income in computing their average tax rate. If the Legislature does not enact retroactive legislation, taxpayers reporting in

this way who are entitled to more credit may ask for refunds, with interest, to recover the credit. Those taxpayers who have claimed too much credit will be liable for the excess amount claimed, plus interest, but not penalties.

The Department of Revenue will update taxpayers on the status of the computation of the average tax rate at the conclusion of the 2005 legislative session.

Examples of Credit Calculations

The calculations described below are only used for expenditures, tax, and taxable amounts attributable to activity taking place on and after July 1, 2004.

1. A business, not a nonprofit corporation or association, that engages in qualified research and development, has a taxable amount of \$10,000,000 in a year. It pays \$80,000 in that year in wages and benefits to employees directly engaged in qualified research and development. The business has no other qualified research and development expenditures.

Its qualified research and development expenditures of \$80,000 are less than \$92,000 (0.92 percent of its taxable amount of \$10,000,000). If a business's qualified research and expenditure expenditures (or eighty percent of amounts received for the conduct of qualified research and development) are less than 0.92 percent of its taxable amount, it is not eligible for the credit.

2. A high technology business, not a nonprofit corporation or association, that engages in qualified research and development, has a taxable amount of \$10,000,000 in a year. Seven million dollars of this amount is taxable at the rate of 0.015 under the B&O tax classification for services and \$3,000,000 is taxable at the rate of 0.00484 under the B&O tax classification for royalties. The business pays \$119,520 in business and occupation tax for this reporting period. It pays \$200,000 in that year to employees directly engaged in qualified research and development. The business has no other qualified research and development expenditures.

In order to determine the amount of its credit, the business subtracts \$92,000 (0.92 percent of its taxable amount of ten million dollars) from \$200,000, its qualified research and development expenditures. The resulting amount of \$108,000 multiplied by the business's average tax rate equals the amount of the credit.

The business's average tax rate is determined by dividing its B&O tax of \$119,520 by its taxable income of \$10 million. The result, 0.01195, is multiplied by \$108,000 to determine the amount of the credit. The credit is \$1,291 (\$1,290.60 rounded to the nearest whole dollar). Because the business does not engage in manufacturing or extracting, its taxable income is equal to its taxable amount. Therefore, this business does not need to be concerned about potential retroactive legislation regarding the definition of average tax rate.

3. A business, not a nonprofit corporation or association, that engages in qualified research and development, has a taxable amount of \$10,000,000 in a year. Seven million dollars of this amount is attributable to manufacturing and \$3,000,000 is attributable to wholesaling. The business pays \$48,400 in business and occupation tax for this reporting period. It pays \$200,000 in that year in wages and benefits to employees directly engaged in qualified research and development. The business has no other qualified research and development expenditures.

In order to determine the amount of its credit, the business subtracts \$92,000 (0.92 percent of its taxable amount of \$10,000,000) from \$200,000, its qualified research and development expenditures. The resulting amount of \$108,000 multiplied by the business's average tax rate equals the amount of the credit.

a. If the business determines its average tax rate in anticipation of the Legislature enacting retroactive legislation substituting taxable amount for taxable income, the business would divide its B&O tax of \$48,400 by its taxable amount of \$10 million. The result, .00484, is multiplied by \$108,000 to determine the amount of the credit. The credit is \$523. If the Legislature does not enact retroactive legislation, the taxpayer will be entitled to a refund of \$1,216, plus interest. (See the next paragraph to see how this number was arrived at.)

b. If the business determines its average tax rate under ESHB 2546, it would divide its B&O tax of \$48,400 by its taxable income of \$3 million. (Taxable income does not include the \$7 million attributable to value of products manufactured.) The result, 0.0161, is multiplied by \$108,000 to determine the amount of the credit. The credit is \$1,739. If the Legislature enacts retroactive legislation substituting taxable amount for taxable income, the taxpayer will be billed for the excess credit claimed of \$1,216 (\$1,739 less \$523) plus interest, but not penalties.

High Tech Sales/Use Tax Deferral/Waiver Program

Effective **June 10, 2004**, the retail sales tax and use tax deferral program for eligible investment projects involving research and development (R&D) or pilot scale manufacturing operations in the fields of advanced computing, advanced materials, biotechnology, electronic device technology and environmental technology is modified as follows:

The expiration date for the program is extended to January 1, 2015.

Participants in the program must complete an annual survey. The survey is due by March 31 of the year following the year in which the project is certified by the Department of Revenue as operationally complete and each March 31 of the seven succeeding calendar years. If the survey is not completed by the due date, 12.5 percent of the deferred tax will be due for payment immediately.

The term “initiation of construction” is defined to mean the date that a building permit is issued. An application for the deferral program must be submitted before the initiation of construction for projects involving construction.

An owner who leases property to a qualifying business may participate in the deferral program if the benefits of the program are passed to the lessee under a written agreement and the lessee agrees to complete the annual survey.

Persons engaged in construction activities for the federal government are not liable for sales and use tax on tangible personal property incorporated into a structure, if the construction project would have qualified for the deferral if undertaken by a private entity.

Small Business Grants Exempted from B&O Tax

Effective **July 1, 2004**, amounts received for research and development under the federal small business innovation research program and the federal small business technology transfer program are exempt from B&O tax.

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